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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

Office-Supreme Court, U.S.
FILED
FEB 26 1970
JOHN F. DAVIS, CLERK

THE NEW HAVEN INCLUSION CASES

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF APPELLEE — RESPONDENT, RICHARD JOYCE SMITH, TRUSTEE, IN SUPPORT OF APPELLANTS — PETITIONERS

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February 25, 1970

TABLE OF CONTENTS

	Page
INTRODUCTION	1
STATEMENT OF THE CASE	2
SUMMARY OF ARGUMENT	14
ARGUMENT	15
I. The Reorganization Court properly exercised its function under the Bankruptcy Act in reviewing a Commission valuation	15
II. The Reorganization Court properly rejected the Commission's discounts for assumed delay in securing an abandonment certificate and for application of a "bulk-sale" condition to such abandonment	20
A. The abandonment and bulk-sale discounts were not "alternative pricing theories" contemplated by the remand order	20
B. The Commision's abandonment-delay discount of $15,386,000 is improper as a matter of law	26
C. The bulk-sale deduction of $6,695,000 is inequitable and without proper basis	34
III. The Reorganization Court properly found that the liquidation value of the New Haven's properties had been understated by the Commission by an additional $6,445,000	36
A. The Commission's valuation of the Bronx yard properties was unsupported by evidence of the nature required by the *Ecker* case; and resulted in an undervaluation of $4,439,000	37
B. The Commission erred as a matter of law in its determination of the discount to present worth; the Reorganization Court properly determined that the discount should be decreased by $2,415,899	40
CONCLUSION	42

TABLE OF CITATIONS

Cases: Page

American Brake Shoe & F. Co. v. *Interborough R.T. Co.*, 122 F.2d 454 (2d Cir. 1941) 34

Arkansas and O. Ry. Corp. Abandonment, 312 I.C.C. 501 (1961) 35n

Baltimore & Ohio Railroad Co. v. *United States*, 386 U.S. 372 (1967) 5, 28

Brooks-Scanlon Co. v. *Railroad Commission of Louisiana*, 251 U.S. 396 (1920) 10, 32

Bullock v. *Railroad Commission of Florida*, 254 U.S. 513 (1921) 10

Chicago A. & E. R. Corp. Abandonment, 312 I.C.C. 533 (1961) 35n

Chicago N.S. & M. Ry. Abandonment of Entire Operation, 317 I.C.C. 191 (1962) 35n

Colorado v. *United States*, 271 U.S. 153 (1926) 32

Ecker v. *Western Pacific R. Corp.*, 318 U.S. 448 (1943) 14, 17, 18, 19, 20, 26, 42

First Nat. Bank v. *Flershem*, 290 U.S. 504 (1934) ... 34

Fort Dodge, Des Moines & Southern Ry. Co. Abandonment, 312 I.C.C. 708 (1961) 35n

New York, New Haven and Hartford Railroad Company, Debtor, In the Matter of Docket No. 30226 (D. Conn.),

Order No. 109 (1962) 3n

Memorandum of Decision Re Petition for Order No. 287 (1965) 5n

Order No. 559 (1968) 12

Penn Central Merger Cases, 389 U.S. 486 (1968)...2, 3, 5

Pennsylvania R. Co. — Merger — New York Central R. Co., 327 I.C.C. 475 (1966) 4n, 27, 28

Second Supplemental Report, 331 I.C.C. 643 (1967) .....5, 6, 7, *et passim*

Fourth Supplemental Report, 334 I.C.C. 25 (1968) .....2, 9, 11, *et passim*
Fifth Supplemental Report, 334 I.C.C. 528 (1969) 13
Railroad Commission v. *Eastern Texas R.R.*, 264 U.S. 79 (1924) 10
Rutland Ry. Corp. Abandonment of Entire Line, 317 I.C.C. 393 (1962).....35, 36
Van Schaick v. *McCarthy*, 116 F.2d 987 (10th Cir. 1941) 34

Statutes:

Bankruptcy Act
Section 77 (11 U.S.C. §205) .....1, 2, 3, *et passim*
Section 77 (b) (5) 35
Section 77 (e) 12, 17, 18, 21, 26
Interstate Commerce Act
Section 1(18) (49 U.S.C. §1(18)) 9, 10, 29, 34
Section 5 (49 U.S.C. §5).....2, 5, 6, 12, 14, 42
Section 5 (2)(c) 3
Section 5 (2)(d) 3
Section 19(a) (49 U.S.C. §19(a)) 18n

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INTRODUCTION

Richard Joyce Smith, appellee-respondent, is Trustee of the property of The New York, New Haven and Hartford Railroad Company, Debtor in reorganization in the United States District Court for the District of Connecticut (No. 30226) pursuant to the provisions of §77 of the Bankruptcy Act (11 U.S.C. §205)[1]. He supports the position of

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[1] Mr. Smith is hereinafter referred to as "Trustee" and said District Court as "Reorganization Court". Mr. Smith, William J. Kirk and Harry W. Dorigan were the trustees originally appointed by the Reorganization Court, and Mr. Smith is presently the sole trustee. References herein to "Trustee" are intended to refer to all of the trustees in office at the particular time.

The appellants-petitioners in Nos. 914, 915, 916, 917, 920 and 921 are hereinafter sometimes collectively referred to as the "Bondholders"; the Interstate Commerce Commission is referred to as the "Commission"; and Penn Central Company is referred to as "Penn Central".

the Bondholders.[2]

These consolidated cases involve appeals from decisions of the Reorganization Court and a statutory Three-Judge Court upon review of the Commission's Fourth Supplemental Report and Order, 334 I.C.C. 25 (1968), (App. 112a), in which the Commission valued the New Haven's properties and fixed the price to be paid for them by Penn Central, pursuant to §5 of the Interstate Commerce Act (49 U.S.C. §5) and §77 of the Bankruptcy Act. Of the numerous issues raised below, the decisions of the Reorganization Court and the Three-Judge Court differed in four areas. Since the other issues raised by the Bondholders' appeals will be fully briefed and argued before this Court by them, this brief will be confined to the four points upon which the two lower courts disagreed.

STATEMENT OF THE CASE

The merger of the Pennsylvania and New York Central Railroads was approved by the Court in the *Penn Central Merger Cases*, 389 U.S. 486 (1968). Inclusion of the railroad operations of the New Haven in the merged Penn Central system was then before the Court as a condition of the approval of the merger, but the proposed terms of the inclusion have not heretofore been reviewed by the Court. The Court specifically approved the Commission's action

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[2] By its order dated February 2, 1970 in these cases, the Court directed the Trustee to file his main brief on the same schedule as the Bondholders. As an appellee-respondent, the Trustee relies on the briefs of the Bondholders for the references or statements specified in, or required by, Rule 40 with regard to the opinions delivered in the courts below, the grounds on which jurisdiction is invoked, the text of the pertinent constitutional and statutory provisions, and the questions presented.

The Appendix of Decisions and Constitutional and Statutory Provisions heretofore filed with the Court in connection with the appeals and petitions for certiorari is hereinafter referred to as "App."; and the Single Appendix filed on February 26, 1970 is referred to as "S. App.".

in conditioning the merger upon the New Haven's inclusion,[3] and indicated that any objections to the inclusion terms raised by the New Haven or the Bondholders could be fully protected through judicial proceedings subsequent to consummation of the merger.[4] The instant cases constitute the proceedings then contemplated by the Court.

The New Haven has been in reorganization under §77 of the Bankruptcy Act since July 7, 1961. From the outset of the reorganization, it was recognized by the Reorganization Court and the Trustee that survival of a major transportation system was at stake. However, with operations producing both a substantial deficit in operating income and in income available for fixed charges, an internal reorganization of the traditional type through the mechanism of a recapitalization of the corporate debt structure would have been ineffective. The reorganization conclusion reached by the Trustee was that consolidation with a trunk line railroad was required. The merger application filed with the Commission in 1962 by the former Pennsylvania and New York Central Railroads made such method of reorganization a realistic possibility in view of §5(2)(c) of the Interstate Commerce Act. Thereupon, the Trustee petitioned the Reorganization Court for authority to file a petition with the Commission pursuant to §5(2)(d) of that Act for compulsory inclusion of the New Haven's operations in the proposed merged company as a prerequisite to approval of the merger.[5]

During the course of the Commission's hearings on their merger application, Pennsylvania and Central vigorously opposed the Trustee's petition for inclusion. However, during the period subsequent to the close of the hearings, but prior to service of the hearing examiners' report, an

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[3] 389 U.S. at 510.

[4] 389 U.S. at 511.

[5] The requested authority was granted to the Trustee by the Reorganization Court in its Order No. 109, dated June 19, 1962.

agreement was reached between them and the Trustee providing for purchase by the merged company of substantially all the New Haven's assets, other than current assets, for a specified consideration.[6] From the Trustee's point of view, this agreement insured the preservation of rail service in Southern New England.

Hearings at the Commission on the terms of inclusion commenced in January, 1967. The Trustee introduced a study of the liquidation value of the New Haven's properties as of December 31, 1965, and studies as to the New Haven's potential earning power as a freight-only or as a passenger-only railroad. Since the results of the various studies indicated that the New Haven could not be viable under any assumed operating configuration, the Trustee urged the Commission to find that liquidation value was the proper standard for evaluating the assets to be conveyed to Penn Central. Penn Central also introduced a liquidation study with data as of the end of 1966. Bondholders presented evidence principally regarding freight-only operations, going concern value, tax attributes and the liquidation value of the New Haven's freight yards in The Bronx, New York.

Although Penn Central's liquidation study arrived at a far lower value for the New Haven's assets than did the Trustee's study, there were no substantial differences in format or theory between the studies. The difference in results stemmed from different opinions as to the market value of certain properties and the expense of liquidating the railroad. Penn Central's study was in accord with the Trustee's in assuming liquidation sales would commence promptly after the valuation date and that the property would be sold piecemeal rather than in bulk.

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[6] A detailed agreement was executed by the Trustee, Pennsylvania and Central on April 21, 1966. It was amended October 4, 1966 to reflect the Commission's first report and order in the Penn Central merger proceedings, *Pennsylvania R. Co. — Merger — New York Central R. Co.*, 327 I.C.C. 475 (1966).

On several occasions during the reorganization, the Reorganization Court noted the constitutional strictures against prolonged continuation of the New Haven's loss operations, and indicated that the resultant erosion of the Bondholders' security could be tolerated only so long as there was a clear prospect of relief.[7] When in March, 1967, in *Baltimore & Ohio Railroad Co.* v. *United States*, 386 U.S. 372 (1967), the Court ruled that consummation of the Penn Central merger would have to await other events, the Trustee petitioned for instructions from the Reorganization Court as to his future course of action.[8] The First Mortgage 4% Bondholders' Committee (appellant-petitioner in Nos. 914 and 915) and a major bondholder then filed cross-petitions seeking termination of the reorganization proceedings and liquidation of the railroad. The Reorganization Court deferred ruling on the petition and the cross-petitions while the Commission was complying with this Court's opinion (App. 231a). They were finally dismissed by the Reorganization Court on the grounds that the Penn Central merger was imminent and that this Court in the *Penn Central Merger Cases, supra*, gave its assurance that the rights of the Bondholders would be protected (App. 234a, 236a).[9]

On November 19, 1967, the Commission issued its Second Supplemental Report and Order, 331 I.C.C. 643 (App. 1a; App. 466a), in which it approved the consideration provided in the Agreement of April 21, 1966 among the Trustee and Penn Central's predecessor companies as the terms for the inclusion under §5 of the Interstate Commerce Act and as a first step in the New Haven's plan of reorgani-

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[7] *E.g., Memorandum of Decision Re Petition for Order No. 287*, S. App. 1c.

[8] Petition for Order No. 441, dated April 5, 1967.

[9] As put by the Reorganization Court (App. 234a):

"To jettison everything achieved and turn back just as a glimmer of light begins to show at the end of a long dark tunnel not only carries with it an aura of unreality but borders on the fantastic."

zation under §77 of the Bankruptcy Act. It also required Penn Central to lend operating funds to the New Haven and to share, up to a maximum of $5.5 million per year, in the New Haven's operating losses during the interim between consummation of the Penn Central merger and the New Haven's inclusion.[10]

There followed appeals by the Bondholders to a statutory Three-Judge District Court in the Southern District of New York, which reviewed the Commission's Order under §5 of the Interstate Commerce Act, and the proceedings before the Reorganization Court for approval of the reorganization plan contemplated by the Bankruptcy Act.

In the Second Supplemental Report, the Commission approved the consideration that had been agreed between the Trustee and Penn Central on the ground that it was equivalent to liquidation value. However, in that Report and in the course of the review proceedings before the two district courts, the Commission took the position that the relevant statutory standards did not require it to award liquidation value to the estate.

The Bondholders contended that the estate was entitled to liquidation value and that the Commission had both undervalued the New Haven's assets and overvalued the consideration to be paid by Penn Central. As noted above, the Trustee's position had been that liquidation value was the proper standard, and that the agreement with Penn Central produced consideration which met that standard. The Trustee, however, had stressed that the liquidation study introduced before the Commission had assigned no value to the New Haven's interest in the Grand Central Terminal properties due to an opinion of counsel advising the Trustee that such interest would terminate upon cessation of the New Haven's railroad operations into Grand

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[10] The Trustee had proposed a loss-sharing formula that would have resulted in a $9.1 million participation based upon 1967 data (App. 75a).

Central Terminal. To the extent that the New Haven had any interest in these properties in a liquidation situation, the Trustee had made it clear that an addition to the liquidation study valuation would be required.

The Reorganization Court referred the Grand Central questions to John Van Voorhis, retired judge of the New York Court of Appeals, as Special Master (App. 252a). He found, in effect, that the opinion of counsel which had guided the Trustee was in error. Both the Three-Judge Court and the Reorganization Court in returning the matter to the Commission found that the liquidation value had been understated, primarily in the case of Grand Central Terminal properties, and that certain of the Commission's calculations and procedures were in error (App. 250a-255a; App. 330a-353a).

The Reorganization Court considered in its review of the Second Supplemental Report that the principal questions before it were: (1) the proper standard of valuation and whether the Commission had conformed to it, and (2) whether continued deficit railroad operations would constitute an unconstitutional taking of the creditors' property (App. 238a).

As to the first question, the Reorganization Court held that "the Penn-Central should pay to the Trustees of the New Haven at least the liquidation value of the New Haven as of December 31, 1966" (App. 239a), and it found that for specified reasons the consideration approved by the Commission did not meet that standard. Regarding the second question, it was stated (App. 245a):

"In view of the history of this deficit operation from the time of the filing of the petition under §77 and even before, the size of the losses, the long period of time necessarily involved in seeking to work out a solution, short of liquidation, through inclusion in the Penn-Central, the present condition of the Railroad and the

rate of loss and out-flow of cash in the recent past and in the foreseeable future, this court finds that the continued erosion of the Debtor's estate from operational losses after the end of 1968 will clearly constitute a taking of the Debtor's property and consequently the interests of the bondholders, without just compensation."

The Three-Judge Court was similarly concerned with the question of the standard of valuation and the need for expediting the New Haven's inclusion in Penn Central. It considered the Commission's position that it could fix a price for the New Haven's property less than its liquidation value to be a concept which "ignores the constitutional right of NH to cease operation and liquidate" (App. 359a), and went on to state (App. 361a):

"We recognize, however, that this legal issue is one of novel impression which only the Supreme Court can authoritatively determine. We therefore suggest in the interest of avoiding another remand that if the Commission disagrees with our view, it should feel free to formulate its own and supply the necessary subsidiary findings. . . . If it does not [agree that the price cannot be less than the liquidation value], *it shall state the pricing theory it has adopted,* the reasons for it, and the results, and shall make whatever detailed subsidiary findings are required to support this." (Emphasis added)

Urging expedition, the Three-Judge Court indicated to the Commission that in the hearings following remand (App. 375a-376a):

"To the extent that new testimony is required, this should be held to a minimum; we do not mean by this opinion that parties who had a full opportunity to present evidence must be given a new turn."

At the Commission's further hearing, in addition to evidence of the nature expressly contemplated by the re-

mand, Penn Central offered evidence for the first time with respect to the valuation significance of (1) a delay in liquidation which would result from the time required for the New Haven to secure from the Commission a certificate of abandonment under §1(18) of the Interstate Commerce Act (49 U.S.C. §1(18); App. 116a, 140a-147a), and (2) a sale of the New Haven's property in bulk as distinguished from a sale in parcels (App. 148a). The Trustee and the Bondholders objected to the receipt of any evidence on either of these points on the ground that it would be outside the scope of the remand. The hearing examiner sustained the objection with respect to the evidence proffered on a discount for delay in processing an abandonment application (S. App. 381c); but, after initially rejecting it, admitted evidence with respect to a bulk sale discount (S. App. 396c)[11].

The Commission's Fourth Supplemental Report and Order[12] were served December 2, 1968. The Commission treated the issues with respect to limitation on the right to abandonment and applicability of a bulk sale discount as aspects of "alternative pricing theories" permitted to be considered by the remand of the Three-Judge Court and the referral of the Reorganization Court (App. 140a-141a). After recognizing, as the Three-Judge Court had indicated, that the question of the minimum price to which the New Haven was entitled was novel, the Commission concluded that because there was a "public need for the services of this railroad, there is no warrant for assuming that the creditors may now break up the railroad or devote the properties to another use" (App. 142a). From this conclusion, the Commission postulated

[11] In reversing himself, the examiner stated with respect to admission of the bulk sale evidence that "although it relates largely to the discount rate on the proceeds of the sale of land, it also deals with some subject matter which may be construed as a pricing theory" *(Ibid.)*.

[12] 334 I.C.C. 25,

that "the estate is not relieved of its obligation to serve the public. A price that is premised on outright rejection of that obligation is inequitable and awards the estate a windfall that is not supported by any record evidence" (App. 142a).

The Commission then went on to hold that, notwithstanding *Brooks-Scanlon Co.* v. *Railroad Commission of Louisiana*, 251 U.S. 396 (1920) and other cases noted,[13] a railroad does not have "an absolute right to abandon, liquidate, and sell the parcels" nor to "break up the railroad and to receive the maximum salvage value" (App. 143a). The Commission considered that "the alleged right to liquidation values derives from an alleged right to abandon; and there are recognized limitations on the right to abandon that in themselves limit the creditors' entitlement to the liquidation value we have computed under the court's instructions" (App. 144a).

The Commission referred to its power under §1(18) of the Interstate Commerce Act to "impose reasonable limitations on the abandonment right" and stated that the "pricing out of such limitations permits us to reach what we consider to be a fair price on the present record, and we need go no further" (App. 144a). In the "pricing out", the Commission concluded that its processing of an abandonment application would require not less than one year and the effect of such a delay would reduce the worth of the estate by at least $15,386,000 (App. 147a), which could "properly be reflected in a reduction of the price Penn Central is to pay" (App. 146a).

The Commission found that there was a further limitation on the right of the Bondholders in the present case as a consequence of the Commission's conclusion that as a "condition of an abandonment certificate", it would not permit the property to be sold in parcels but only in bulk,

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[13] *Railroad Commission* v. *Eastern Texas R. R.*, 264 U.S. 79 (1924) and *Bullock* v. *Railroad Commission of Florida*, 254 U.S. 513 (1921).

in order to preserve the property for rail service (App. 148a). The Commission stated that "we, therefore, might compel NH, if it filed for abandonment, to sell in bulk and thereby make a bulk sale price appropriate" (App. 148a). This additional discount was computed by the Commission to be "at least $6,695,000" (App. 149a).

In the Second Supplemental Report, the Commission had found $125.8 million to be the net liquidation value of the properties being sold to Penn Central (App. 139a) and used that as the test for determining the adequacy of the consideration to be received by the New Haven. In the Fourth Supplemental Report, this was formally raised to $162.7 million (App. 140a).[14] However, the Commission's finding that "the limitations that lawfully may be placed on the creditors' right to abandon and break up the property justify reduction of at least $22,081,000 in the price" (App. 150a) resulted in reducing the amount to be paid for the New Haven's assets to $140.6 million. In addition, Penn Central was ordered to pay $5 million under the loss-sharing formula approved in the Second Supplemental Report. (App. 158a)

The Fourth Supplemental Report provided that the transfer to Penn Central of the New Haven's assets and operations should be effected by January 1, 1969 upon payment of the consideration therein provided, without prejudice, however, to the rights of the parties thereafter to seek judicial review of the sale price (App. 163a).

On December 24, 1968, the Reorganization Court entered an order approving the transfer to Penn Central as a "first step" in the New Haven's plan of reorganization and instructing the Trustee to carry out the conveyance and receive the consideration fixed by the Commission,

[14] The Commission found a gross value for assets being conveyed to Penn Central of $200.5 million, which was reduced by liquidation expenses of $39.9 million, a discount to present worth of $17.6 million, other downward adjustments of $9.2 million, plus an upward adjustment for the Grand Central Terminal properties of $28.9 million.

subject to a general reservation of jurisdiction to review the plan of reorganization, including objections already filed as to the amount of consideration.[15]

Penn Central sought a stay of the inclusion order from the Three-Judge Court, which was denied (App. 393a). The New Haven's assets and operations were transferred to Penn Central, and the consideration prescribed by the Commission was paid to the Trustee, on December 31, 1968.

As in the case of the Commission's Second Supplemental Order, there were judicial reviews by a Three-Judge Court in the Southern District of New York with respect to the Commission's findings under the Interstate Commerce Act, and, upon certification by the Commission of its plan of reorganization under §77(e), by the Reorganization Court.

On May 28, 1969, the Reorganization Court entered its memorandum of decision on the issue of price (App. 277a), the findings of which were incorporated into an order, dated July 28, 1969, approving the plan of reorganization except as to certain aspects, primarily those involved in this proceeding (App. 316a). It found that the Commission had erred, as a matter of law, in six respects, of which the following four remain in controversy:[16]

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[15] Order No. 559; App. 269a.

[16] Both courts previously had directed the Commission to remove from its calculation of liquidation value a deduction of $16.2 million for accrued real estate taxes. In the Fourth Supplemental Report it complied to the extent of $14.6 million, but left $1.6 million as a part of the liquidation expenses, which both courts considered to be error.

Both courts also considered to be error the finding by the Commission of a liquidation value of $1.5 million for so-called "CCBI's" to be issued to the New Haven by Boston and Providence Railroad Corporation.

The effect of these two errors, one an increase, the other a decrease, was essentially a wash. The Commission and Penn Central have accepted these rulings.

1. In imposing a discount of $15,386,000 for delay in abandonment;

2. In imposing a discount of $6,695,000 for sale in bulk;

3. In its valuation of the New Haven's Harlem River and Oak Point Freight Yards, which the Reorganization Court considered would require an increase of $4,439,000; and

4. In its computation of the discount to present worth used in determining liquidation value, which the Reorganization Court considered would require an increase of $2,415,899.

In addition to these errors, the Reorganization Court considered that it should require Penn Central to "underwrite" a market value of $87.50 per share by February 1, 1978 for its stock received by the New Haven in part payment of the purchase price.

The Three-Judge Court's opinion was entered June 18, 1969. It disagreed with the Reorganization Court on items 1, 2 and 3, one Judge dissenting, on the ground of the limited nature of its scope of review. It agreed with the Reorganization Court on the need for the "underwriting" and the two items of price no longer in dispute. It directed the Commission to compute the necessary adjustment to the discount to present worth raised by item 4.

The Commission issued its Fifth Supplemental Report and Order,[17] dated July 10, 1969 (modified August 26, 1969; App. 222a), in which it incorporated the modifications to its Fourth Supplemental Report and Order found to be required by the Three-Judge Court, which then entered its decree on September 11, 1969 (App. 446a).

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[17] 334 I.C.C. 528; with respect to the recomputation of item 4, the Commission ordered an adjustment of $410,000 rather than the $2,415,899 indicated by the Reorganization Court.

SUMMARY OF ARGUMENT

In its review of the Commission's Fourth Supplemental Report under §77 of the Bankruptcy Act, the Reorganization Court differed in four respects with the Three-Judge Court, which reviewed the same Report under §5 of the Interstate Commerce Act. In each of these four areas, the Reorganization Court found that the Commission had undervalued the properties of the New Haven and understated the price that Penn Central should be required to pay for those properties.

Two of the four areas involve the propriety of the Commission's method of valuation. These specifically relate to its deductions for the cost to the estate of a hypothetical delay of one year in commencing liquidation while an abandonment proceeding would be administratively processed by the Commission; and for an assumed, compulsory bulk-sale discount to reflect the effect of a condition which the Commission might impose in granting abandonment which would require the sale of the New Haven properties only in bulk. The other two areas relate to the Commission's valuation of railroad yard properties in The Bronx, New York and to the correct determination of the discount of liquidation proceeds to present worth.

The function of the Reorganization Court, upon certification by the Commission of its valuation of a debtor's property, is governed by this Court's decision in the *Ecker* case. The scope of review under §77 of the Bankruptcy Act of an order of the Commission is limited. The Reorganization Court's function is to assure itself that the Commission's valuation has been reached in accordance with legal standards and that it is supported by material evidence. The Reorganization Court fully recognized the limits of its function and carried it out in accordance with *Ecker*.

The Commission's $22 million reduction in the New Haven's net liquidation value, which represented discounts

of $15,386,000 for possible "abandonment delay" and $6,695,000 for a "bulk-sale", respectively, was correctly found by the Reorganization Court to have been contrary to applicable legal standards. These discounts could not be sustained as pricing theories of the nature open to the Commission on remand and were based on an assumption which would visit unconstitutional consequences to the New Haven, and produce improper and inequitable results.

The Commission's valuation of the New Haven's Bronx yard properties was based on an unsupported premise that the property would not have future rail service, and constituted an undervaluation of $4,439,000.

The Commission's determination of the discount to present worth was overstated by $2,005,899 and resulted from improper arithmetic computation.

ARGUMENT

I. THE REORGANIZATION COURT PROPERLY EXERCISED ITS FUNCTION UNDER THE BANKRUPTCY ACT IN REVIEWING A COMMISSION VALUATION.

In their petition for a writ of certioriari in the instant cases, the United States and the Commission stated the question before the Court to be whether the Reorganization Court (in contrast to the Three-Judge Court) improperly substituted its independent judgment of the New Haven's liquidation value for the Commission's determination.[18]

The question was particularized by them by referring to the "rejecting" of the Commission's findings that the valuation in liquidation should reflect the costs of a one-year delay before an abandonment certificate could be obtained and the "risks" that the New Haven would incur in

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[18] Petition in No. 1057, p. 3.

selling its properties piecemeal rather than in bulk,[19] and the conclusions of the Reorganization Court that the Commission's findings as to the value of yard properties in The Bronx and its computation of the discount of liquidation proceeds to present worth were erroneous as a matter of law.

In its cross-petition for a writ of certioriari, dated January 5, 1970, Penn Central concurred in the government's statement of the question presented, stating that the issues are substantial "because of the Reorganization Court's usurpation of the valuation function assigned by Congress in 1935 exclusively to the Commission."[20]

These contentions that the Reorganization Court invaded the functions of the Commission and improperly substituted its own judgments as to valuation in a domain ex-

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[19] The Trustee considers that the reference to "risks" does not adequately state the substance of the Commission's findings in this regard. To be sure, the Commission determined that a discount would be required in order to reflect a bulk sale price (App. 149a). However, the *finding* upon which the discount must rest is the Commission's statement that "we, therefore, might compel NH, if it filed for abandonment, to sell in bulk and thereby make a bulk sale price appropriate. The question then becomes what is such a price." (App. 148a). At a prior point in the Fourth Supplemental Report, the Commission made it wholly clear that it was not adopting a theory of the monetary *risks* of piecemeal sales vs. bulk sale but that it was relying on its right to *require* the property to be sold at a bargain price in order to preserve it in the public service. In rejecting Penn Central's analysis of a *risk* discount as not meeting the Bondholders' position, it stated (App. 148a):

"But Penn Central's analysis overlooks what is necessarily the bondholders' position — namely that aside from principles of equity and fairness they have a fixed right to sell off NH in parcels, so that even a bulk buyer must pay the per-parcel price. Our answer is that *we may compel the bulk sale and the bulk sale discount as a condition of an abondonment certificate, and, therefore, as a reduction of the present price.*" (Emphasis added)

[20] Petition in No. 1038, p. 9.

clusively reserved for the Commission must necessarily rest on an examination of §77(e) of the Bankruptcy Act and this Court's prior holdings as to the meaning thereof.

Section 77(e) provides that, if a valuation of any property of the debtor is necessary for any purpose, determination shall be made by the Commission, which shall certify it to the reorganization court in its report on the reorganization plan. The function of a reorganization court is then to assure itself that the Commission's determination of value is supported by material evidence and reached in accordance with legal standards. *Ecker* v. *Western Pacific R. Corp.*, 318 U.S. 448, 473 (1943). As stated by the Court in the *Ecker* case, "valuation is a function limited to the Commission, without the necessity of approval by the [reorganization] court" (*Id.* at 472).

While its function with respect to the valuation of the debtor's property is thus circumscribed, the reorganization court, as the Court made clear, retains a significant function. The examination whether the Commission's determination was "reached with material evidence to support the conclusion and in accordance with legal standards" (*Id.* at 473), the Court pointed out, "leaves open the question of whether in reaching the result the Commission had applied improper statutory standards. This latter point is discussed under the heading of *Method of Valuation* in this opinion . . ." *(Ibid.)*.

Under the heading "Method of Valuation" (*Id.* at 477), the Court found that, in its review of the Commission's valuation, the reorganization court is "to determine whether the Commission has followed the statutory mandates of subsection (e)." After quoting from subsection (e), the Court described the scope of the reorganization court's review of the valuation entrusted to the Commission under §77(e), as follows *(Ibid.)*:

"Thus, while judicial review does not involve an independent examination into valuation, it does require that the court shall be satisfied, upon the record before the Commission, *with such additional evidence as may be pertinent to the objections to the Commission's finding of value,* that the statutory requirements have been followed." (Emphasis added)

Section 77(e) requires that, in reaching its valuation determination, the Commission must employ a number of specified analytical tools and others which are unspecified but are picked up by the phrase "and all other relevant facts." It is specified that valuation shall be determined "on a basis which will give due consideration to the earning power of the property, past, present and prospective." The statute then proceeds to limit the use of other specified conventional analytical tools which are historically employed in rate-making, as distinguished from valuations upon which creditors' rights are ascertained. In valuing the carrier, the Commission shall give *only* such effect to the present cost of reproduction new and less depreciation, the original cost of the property and the actual investment therein "as may be required under the law of the land, in light of its earning power and all other relevant facts."[21]

The Reorganization Court was fully aware that the scope of its review of the Commission's valuation determination was limited and how it had been limited by this Court. In its first memorandum on the reorganization plan, the Reorganization Court stated that it was not empowered to make "a new finding of value, which lies in the sole province of the Commission", citing the *Ecker* case (App. 252a).

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[21] These specific approaches to valuation which are thus limited under §77(e) are, however, included without equivalent limitation in §19(a) of the Interstate Commerce Act (49 U.S.C. §19(a)), under which the Commission is directed to determine and keep up to date the valuation of railroad properties.

Consistent with this recognition, in its memorandum of decision on the issue of the price to be paid for the debtor's assets, the Reorganization Court did not attempt to make *de novo* valuations, as such, but reversed the Commission only on specific items where it found the Commission had committed errors of law (*e.g.*, App. 291a, 292a, 294a, 295a, 298a, 302a). In its order adjudging the price to be paid by Penn Central, it seems clear that the Reorganization Court considered that it was reaching findings and conclusions that statutory requirements had not been followed (App. 318a).

Of the four areas in which the Reorganization Court and the Three-Judge Court disagreed, two relate to the appropriateness of the Commission's method of valuation. The Reorganization Court did not find that alternative dollar conclusions should be reached in these instances, but that the entire concept employed by the Commission was contrary to legal standards. These instances are the reduction of the liquidation value of the New Haven properties to reflect the time the Commission said would be needed to process an abandonment application, and a reduction to reflect the Commission's conclusion that it could insist upon a bulk sale of railroad properties at a discount price as a condition of abandonment. These "Methods of Valuation" have no heritage to which the United States, the Commission or Penn Central can point as support for the validity of their concept. The Reorganization Court was entitled to conclude under the *Ecker* case that its review function included the power and obligation to reverse the Commission's findings in these respects.

The two other areas where the lower courts differed involve the valuation of the New Haven's Harlem River and Oak Point Freight Yards and the amount of correction necessary to restate properly the discount to present worth of liquidation proceeds. In both instances, the findings of the Reorganization Court were within the area of its func-

tion described in the *Ecker* case to determine whether the Commission's conclusions were supported by material evidence and in accordance with legal standards.

II. THE REORGANIZATION COURT PROPERLY REJECTED THE COMMISSION'S DISCOUNTS FOR ASSUMED DELAY IN SECURING AN ABANDONMENT CERTIFICATE AND FOR APPLICATION OF A "BULK-SALE" CONDITION TO SUCH ABANDONMENT.

A. The abandonment and bulk-sale discounts were not "alternative pricing theories" contemplated by the remand order.

In its Fourth Supplemental Report, the Commission recognized that both lower courts "suggested that the Constitution requires us to establish a price for the assets of the estate at no less than their liquidation value" (App. 140a). The Three-Judge Court, conceiving that a novel legal issue was involved, directed the Commission, in the event it should not agree that the price to be paid by Penn Central could not be less than liquidation value, to state its pricing theory with a full exposition of its reasons and computations (App. 361a).

The Commission concluded that "an inflexible rule of law prescribing liquidation value (as computed above) as the minimum to which the creditors are entitled might lead to unfair results" (App. 141a). It stated that there were other considerations relevant to the price to be paid and received in this instance and that liquidation value as found by the Commission before application of these other considerations was "not itself a fair and equitable price and is not required as a matter of law. It is fair neither to the estate nor to Penn Central." *(Ibid)*. These other price considerations were then formulated upon the premise that "it is inequitable to conceive at the same time both a right in the bondholders to break up the NH and an obligation on Penn

Central to keep it going" *(Ibid).*[22] The Commission concluded that it could not permit a liquidation of the New Haven without a formal abandonment proceeding in which the public interest might require the Commission to deny a certificate of abandonment. Accordingly, the Commission determined that the consequential effect would be discounts, from what would otherwise be the liquidation value of the property, which would aggregate over $22 million. These discounts represented the assumed expenses of carrying out a hypothetical abandonment proceeding which would require the Commission to spend a minimum of a year for administrative processing and which, at the end of the year, would result in a record making it necessary for the Commission to condition an abandonment certificate upon a sale of the property solely in bulk (App. 142a-150a). These discounts do not consitute methods of valuation or alternative pricing, but simply the application by the Commission of a structured concept to produce a result which the Commission considered to be required by colloquial fairness to Penn Central in the context of its being required to continue the New Haven's loss operations.

It was expressly found by the Commission in the Second Supplemental Report that the New Haven's properties never could be considered to have earning power. The specific valuation standard provided by §77(e) is "earning power of the property, past, present, and prospective;" the Commission has recognized the New Haven's lack of earning power time and again in the history of the reorganization and prior thereto.

In the Second Supplemental Report, the Commission considered every significant fact dealing with the New Haven's potential as an operating railroad and the deleterious impact upon Penn Central which was being visited

[22] There is no explanation by the Commission why such a conception, under the circumstances of its own and this Court's approval of the Penn Central merger, is "inequitable".

by the requirement of New Haven's inclusion as a condition of the Penn Central merger. The Commission put it as follows (App. 45a):

> "If there is one thing on this record that is clear and undeniable, it is that NH has neither earning power nor the prospect of earning power. Further, the facts preclude our finding that Penn-Central can, by some dramatic maneuver or otherwise, suddenly convert NH into a profit-maker. Standing as obstacles are such things as the economics of the particular environment, the unremunerative features of certain common carrier obligations, the carrier's compounded debt, the entrenchment of intermodal competition, and other factors — from which we cannot, in these transactions, fully insulate Penn-Central."

The New Haven's situation, furthermore, is not an instance where a railroad in reorganization is merely held to be "unprofitable", so that it may be appropriate to apply the Commission's concept that "we cannot conclusively presume that the public interest would allow the dismantling of a carrier which is losing money" (App. 142a). The New Haven had suffered a deficit in *net railway operating income* throughout its reorganization and even prior thereto. That is to say, its railroad operations could not even produce income to pay wages, materials and supplies and other costs of operation (App. 243a-244a):

Net Railway Operating Deficit
(millions of dollars)

1961	19.6	1965	16.0
1962	11.5	1966	13.0
1963	10.1	1967	20.2
1964	17.1	1968	12.2 (6 months ending 6/30)

If it is assumed, *arguendo*, that the application of the Commission's abandonment premise and, consequently, its computation of discounts would constitute a pricing

theory, such a premise could under no circumstances be properly applied in the instant case. Necessarily, in the application of this premise, the Commission must rely on the legal sufficiency of its conclusion that the "estate is not relieved of its obligation to serve the public. A price that is premised on outright rejection of that obligation is inequitable and awards the estate a windfall that is not supported by any record evidence." (App. 142a). In the case of the New Haven, this abandonment premise is wholly inapplicable. Even apart from constitutional issues with respect to the extent that loss operations could be compelled, as to which the Commission and the Reorganization Court disagree, it is undeniable, from a practical standpoint, that the New Haven would have one day merely ceased to operate as its ability to continue to borrow more cash ended, and that a *de facto* liquidation would then be in process.[23]

The Reorganization Court considered these issues at length in its memorandum of decision, dated August 10, 1968, concerning the Second Supplemental Report (App. 237a). It noted that there was a continuing public interest at that time in preserving the New Haven's operations and that the Commission should be afforded an opportunity to consider whether it should enter an order requiring Penn Central to take over the New Haven's operations not later than January 1, 1969, leaving the price and other terms to be determined subsequently. Although this deadline was less than five months in the future, the Reorganization Court made it clear that it could not permit operations to continue thereafter at the expense of the creditors and that, even if the estate did not have an abandonment certificate in hand, the trains would necessarily stop. As the Reorganization Court put it (App. 245a):

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[23] This analogy to the fate of the "one-hoss shay" actually had a recent parallel in the case of the New York, Ontario and Western Railway (cited at App. 146a and 290a).

"If the Commission decides not to issue such an order this court will reluctantly be forced to entertain a motion to dismiss the reorganization proceedings. §§77(e) and (g). While liquidation will have to await authority to abandon, *the trains will stop in January because, with no money with which to pay employees, suppliers and materialmen, actual operation of the Railroad will cease.*" (Emphasis added)

* * *

"In view of the history of this deficit operation from the time of the filing of the petition under §77 and even before, the size of the losses, the long period of time necessarily involved in seeking to work out a solution, short of liquidation, through inclusion in the Penn-Central, the present condition of the Railroad and the rate of loss and out-flow of cash in the recent past and in the foreseeable future, this court finds that the continued erosion of the Debtor's estate from operational losses after the end of 1968 will clearly constitute a taking of the Debtor's property and consequently the interests of the bondholders, without just compensation."

The liquidation study introduced in evidence by the Trustee at the hearings which led to the Second Supplemental Report valued the New Haven's assets on an assumed liquidation. This was the only economic alternative to continued operation which it was then or thereafter realistic to assume. There was no suggestion by any party or the Commission that the valuation so determined should be discounted by reflecting the further economic consequence of an assumed period of time for termination of the reorganization proceedings, prosecution of an abandonment application and conclusion of possible related court proceedings. Penn Central itself submitted a liquidation study at such hearings which did not premise any abandonment proceeding with consequential delay or bulk sale discounts. Nor was there any suggestion in the Commission's Second Supplemental Report that, absent such discounts, the

estate would be overpaid for its property. Not until both the Reorganization Court and the Three-Judge Court had remanded the valuation question to the Commission with instructions that called for various increases in the price to be paid by Penn Central did the Commission conclude that these two major discounts were demanded. Furthermore, to reach the stage where its computation of a discount of $15,386,000 for the one-year delay in processing an abandonment application could be justified, the Commission had to conclude that "evidence thereon was unnecessary" (App. 116a), since the evidence proffered by Penn Central in this respect had been rejected by the hearing examiner on the objection of the Trustee and other parties *(Ibid).*

In his partial dissenting opinion in the Three-Judge Court, Judge Weinfeld stated the reason why he, contrary to his colleagues, could not accept justification of the discounts as a product of the Commission's expertise, as follows (App. 435a-436a):

> "Always central to the merger was the inclusion of the bankrupt New Haven. Were this not the fact, an abandonment proceeding would have been compelled in the light of the year-by-year losses and the constant erosion of the bankrupt estate, with a favorable determination foreordained. [footnote omitted] The Reorganization Court has fully set forth, in its rejection of the abandonment delay concept, incontrovertible facts that expose the lack of substance to the contention that the failure to apply for a certificate of abandonment before 1967 worked a waiver of the bondholders' rights to the full liquidation value."

If the discounts constituted the kind of valuation methods contemplated by the remand to the Commission of the Second Supplemental Report, then they must certainly be examined as a "method of valuation" within the con-

templation of the *Ecker* case. As such, judicial review requires that the reorganization court "shall be satisfied, upon the record before the Commission, with such additional evidence as may be pertinent to the objections to the Commission's findings of value" (*supra*, at 477) that the valuation standards set forth in §77(e) have been met. Nowhere in the Fourth Supplemental Report does the Commission indicate how it conceives that the concept underlying these discounts is a statutory standard encompassed by §77(e), and it would appear that there is no statutory foundation for acceptance of the abandonment concept unless it is the phrase "other relevant facts." If this be the statutory foundation, then the Commission's premise that the grant of an abandonment application was not "foreordained" (*cf.* Judge Weinfeld's contrary premise, App. 435a), but a matter which could be treated as possible of pragmatic alternative conclusions, cannot be sustained on the record before the Commission and the history of the reorganization.

B. The Commission's abandonment-delay discount of $15,386,000 is improper as a matter of law.

The Commission states that "the establishment of liquidation value as a pricing floor on this record must assume that the NH may be shut down at once and be liquidated in parcels. Such a pricing theory assumes that the public may be denied an opportunity to be heard." (App. 141a). That conclusion is unwarranted. In fact, such a pricing theory assumes only that any necessary abandonment authority had been obtained at the time liquidation commenced. The assumption may be tested by the facts of the New Haven reorganization, including the prior conduct of all parties.

Contrary to the Commission's hypothesis, it was only the possibility that the New Haven could be continued in operation through imposition of its inclusion in Penn Central that

prevented an abandonment application from being filed years before. In 1967, months before even the *Second* Supplemental Report was entered, certain of the Bondholders asked the Reorganization Court to terminate the reorganization and liquidate the New Haven (App. 231a). In its memorandum of decision denying this petition, the Reorganization Court, clearly reacting to an incentive to save the service for the public, noted that inclusion in the Penn Central merger then appeared realistic, stating that "a glimmer of light" was beginning to show "at the end of a long dark tunnel" (App. 234a). For the Commission to state under these circumstances, in determining the liquidation value of the estate, that "any assumption that NH may be shut down and broken up must necessarily permit the conclusion that Penn Central may be relieved of its inclusion obligation" (App. 141a) is not only contrary to fairness but a *non sequitur.*

There can be no doubt on this record that, had the Commission itself not made it perfectly clear years ago that the New Haven's properties would be included in Penn Central and the estate paid a fair price for those properties, the Reorganization Court would have long since terminated the reorganization proceedings and taken steps to liquidate the railroad. Following the Trustee's petition for inclusion of the New Haven in Penn Central, the Commission's hearing examiners issued their report on March 29, 1965 recommending inclusion of *only* the New Haven's freight operations in the merged system. Subsequently, the Trustee and Penn and Central arrived at an agreement for such inclusion, but in its first decision in the Penn Central proceedings (327 I.C.C. 475), the Commission directed inclusion of *all* New Haven's operations (that is, including its passenger service) on terms and conditions thereafter to be determined. Clearly, even at that date (April 6, 1966), had the decision of the Commission been against inclusion, it is reasonable to assume that an abandonment proceeding could have been commenced and terminated long be-

fore January 1, 1968, the date assumed by the Commission in the Fourth Supplemental Report.[24]

The Three-Judge Court understood that the Commission assumed that a decision to abandon would not have been taken before January 1, 1967 and that, accordingly, an abandonment certificate would hypothetically have been granted on January 1, 1968 (App. 413a). The Three-Judge Court said that it saw "no inexorable logic that required the Commission to assume that liquidation could have started a year earlier when the *first* appeal in the Penn-Central merger had yet to be argued in the Supreme Court" *(Ibid).* This conclusion fails to appreciate that the merger and New Haven's inclusion had been actually approved by the Commission on April 6, 1966 (327 I.C.C. 475) and that, if not so approved, it cannot fairly be assumed that nothing would have been done by the Reorganization Court, either on its own motion or at the behest of the Trustee, before January 1, 1967. In fact, *after* this Court had decided the first appeal in *Baltimore & Ohio* v. *U.S., supra,* on March 27, 1967, the Trustee, on April 5, 1967, filed with the Reorganization Court his petition for Order No. 441 (App. 229a) seeking instructions as to the estate's future course of action. In subsequently ruling thereon, the Reorganization Court pointed out that there had been a continuing financial deterioration of the New Haven, that sizable cash losses for 1967 were estimated, that a protracted delay in culmination of the Penn Central merger was likely, and that the Trustee would be unable to continue operations without "tapping funds in the registry of the court" (App. 230a-231a).

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[24] The financial stringencies resulting under circumstances of a Commission holding that inclusion would not be required would have been even more severe than otherwise existed, since a shift of rail freight traffic to other modes would have ensued. A *de facto* abandonment would have occurred almost immediately.

In that memorandum, the Reorganization Court squarely considered whether an abandonment would have been promptly sought if it had appeared that the New Haven would not be included in Penn Central, stating (App. 232a-233a):

> "From the time of the I.C.C.'s order of April 8, 1966, making inclusion of the New Haven a condition of the Penn-Central merger, to the present, every opinion of every court has accepted or expressly approved the inclusion of the New Haven in the merged Penn-Central system."
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> * * *
>
> "The Supreme Court opinion made it abundantly clear that it approved the Commission's conclusion that the continuation of the operations of the New Haven was essential and this could be effectuated only by prompt consummation of the Penn-Central merger. It follows that the inclusion of the New Haven must be accomplished as soon as possible and that meanwhile the Trustees are expected to continue operating the New Haven. These are the objectives now to be pursued."

There was no suggestion during the Commission hearings that any party, least of all the Commission itself, would urge that the estate be penalized for not having filed an abandonment application. Such an application could have been filed at any time with authorization of the Reorganization Court since authority once obtained under §1(18) is wholly permissive and not mandatory. Had there been any suggestion of a need for the New Haven to have an abandonment certificate in hand,[25] the appropriate proceedings could have been instituted.

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[25] There is no indication in the Reorganization Court's memorandum of decision on the attempt of bondholders in 1967 to terminate the reorganization proceedings and liquidate the railroad as to participation of the Commission in the proceeding (App. 229a-231a). The understanding of the Reorganization Court as to the Commission's

The Commission concluded that to proceed on an assumption that an abandonment certificate would have been sought years ago "is hindsight observation and hardly a basis for determining price at this time. The fact is that both the creditors and the trustees exercised options, assuming the risks involved therein, and the bondholders may not now be heard to ascribe to someone else the responsibility for the selection of their course of action, or inaction." (App. 145a). This position is completely unfair and unwarranted by the record.

The history of the various steps taken by the Trustee and the Reorganization Court to postpone liquidation is wholly disregarded by the Commission when it characterizes the likelihood of abandonment as "hindsight." The Reorganization Court has specifically pointed out that "by late 1963 it was clear to the Trustees of the New Haven and to the Reorganization Court that only two courses were open: the Trustees must press to accomplish the inclusion in a Penn Central merger or they must press for liquidation. The former was obviously in the public interest and the latter was not." (App. 283a)

The Reorganization Court stressed that it would be

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position in connection with such attempt to secure a liquidation, however, is stated as follows (App. 235a):

"It would be an abuse of discretion and error on the part of this court to entertain and approve of action by the cross-petitioners designed to scuttle the entire reorganization proceeding when such a course, *which the I.C.C. has declared would, at best, be of no benefit to the creditors,* was not indorsed by other representatives of the bondholders or creditors and at a time when the prescribed steps under §77 of the Bankruptcy Act have reached their final stages and a plan of reorganization under the Act has been found to be feasible, and a specific plan has been approved and is about to be certified to this court. The cross-petitioners have no right to maintain what in essence is a collateral attack on the Commission's order and report which are subject to statutory provisions for direct review, toward which steps have already been taken." (Emphasis added)

inequitable to penalize the New Haven for the cost of a hypothetical delay of liquidation while abandonment authority was being obtained. It pointed out that "but for the adoption by the Trustees of a course to serve the public interest, abandonment proceedings *could and would have been commenced in late 1963* and liquidation would have been started, certainly by the valuation date of December 31, 1966." (App. 285a; emphasis added)

Furthermore, the effect of the Commission's abandonment-delay deduction is to impose an additional reduction in the December 31, 1966 valuation upon which the Commission's liquidation findings are based. From that date through December 31, 1968, the New Haven bore substantial losses from the railroad's operations, mitigated only to an extent by the "loss-sharing" provisions of the Commission's inclusion order. The losses borne during this period included not only taxes and other expenses that would have been incurred if the operations of the railroad had ceased and an abandonment application was being prosecuted, but substantial operating expenses as well. These losses were so severe that the Commission expressed concern in its Second Supplemental Report over the fact that Penn Central would have to bear them after inclusion. It stated "Penn-Central must assume a loss-operation which not merely lacks promise of foreseeable recovery, but in fact is plagued by an unrelenting erosion. Thus, they are faced with constantly diminishing going concern values. The cold, hard fact is that NH has been losing money for years and that unfortunate situation continues unarrested."[26] (App. 55a). The substantial unreimbursed losses borne by the estate in the two years between the valuation date and the actual date of inclusion constitute, in fact, an additional abandonment-delay discount.

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[26] Financial data from 1961 through July, 1968 are shown at App. 243a-244a.

With respect to the Commission's view that the Trustee and Bondholders, and presumably the Reorganization Court, exercised options in the past by not proceeding to a termination of the reorganization, the Commission itself observed in the Second Supplemental Report that the Trustee had concluded by December 31, 1963 that "NH could not be reorganized short of inclusion in a major trunk-line system" (App. 56a).

The Commission concluded that the New Haven would not have been entitled to an abandonment certificate as a matter of right. Apparently recognizing, at least under the facts of this case, that such a conclusion could not be reconciled with the decision of the Court in *Brooks-Scanlon Co.* v. *Railroad Commission of Louisiana, supra,* the Commission dismissed that case with the observation that it was overruled *sub silentio* by the Court's decision in *Colorado* v. *United States,* 271 U.S. 153 (1926) (App. 142a-143a). The Reorganization Court noted the inconsistency of the Commission in this regard[27] (App. 286a-291a), and the Three-Judge Court stated that it did not agree with the Commission's conclusion that it would not "have been constitutionally required to issue a certificate of abandonment if inclusion was not a viable alternative" (App. 412a).

The Three-Judge Court accepted, however, the Commission's assumption that a certificate would not have been received until January 1, 1968, stating: "Viewing the matter in a practical rather than a theoretical frame, what the Commission has done here was to select a fair date for shifting the heavy losses of NH's operation from the bondholders to PC — a judgment peculiarly in its province" (App. 413a). Even during the year 1967, however, which the Three-

[27] The Reorganization Court pointed out that the Commission had itself relied on *Brooks-Scanlon* in its report, dated April 25, 1968, authorizing abandonment of Tennessee Central Railway Co. (App. 306a).

Judge Court considered to be the assumed abandonment-delay year under the Commission's decision, the New Haven bore losses of over $20 million in rail operations (App. 244a). Losses in 1968 were even greater and were mitigated only in part by the loss-sharing provisions of the Commission's inclusion order.

Under these circumstances, Judge Anderson and Judge Weinfeld each found the Commission's abandonment-delay deduction to be wholly unfair. The majority of the Three-Judge Court, however, found it could not conclude that the Commission's decision on this point was irrational (App. 411a-412a), apparently mindful of its own prior conclusion, later confirmed by the Commission in its Fourth Supplemental Report, that even had the Trustee been authorized by the Reorganization Court to file abandonment applications years ago as an alternative to New Haven's inclusion petition, "the Commission would almost certainly have deferred their consideration for a reasonable period while inclusion was being explored" (App. 146a; App. 410a). Thus, the Commission and the Three-Judge Court's majority would penalize the New Haven for not having sought abandonment authority while the inclusion petition was pending, yet at the same time conclude that such an application would have been ineffective to hasten abandonment because of the obvious desirability of exploring the possibility of inclusion.

The Three-Judge Court's majority concluded that the effect of the Commission's treatment of the abandonment-delay question was simply to shift the losses in the New Haven's operations from the bondholders to Penn Central as of January 1, 1968 (App. 413a-414a). Since the Commission, however, required Penn Central to bear only a portion of the losses from operations for 1968 not in excess of $5,000,000, the New Haven continued to bear a substantial loss even after application of the abandonment discount.

C. The bulk-sale deduction of $6,695,000 is inequitable and without proper basis.

The "bulk-sale" discount from net liquidation value rests on the premise that the Commission may compel the sale in bulk of railroad properties by so conditioning a grant of abandonment authority under §1(18) of the Interstate Commerce Act. The discount necessarily assumes as a further premise that such a compulsory bulk sale may also be required at a discounted price, i.e., a price less than net liquidation value (App. 148a). There is no precedent in the Commission's own decisions for requiring a *discounted* sale of railroad property, and the judicial cases cited in its discussion of the scope of its power *(Ibid.)* do not support its conclusion. The cases cited, *Flershem, American Brake Shoe,* and *Van Schaick,* support the Commission's statement that the objective of railroad reorganization proceedings is to preserve railroad operations and that, accordingly, public need may require its preservation as a going concern. None of these cases, however, holds that in order to protect the public interest in railroad service a sale of railroad property may be required at less than fair market or net liquidation value. The Commission's statement that "an appraisal of parcels does not apply 'to reorganizations of railroads or corporations the continued existence of which was to the public interest' " (App. 148a) is ill-founded if the Commission means that a bulk sale for continued rail operation could be compelled at a price less than the fair value of the property.

The Three-Judge Court did not adopt the Commission's reasoning of a right to force a bulk sale at a reduced price. It expressed "the gravest doubt concerning the legal premise underlying this argument", and also said that this premise and the Commission's assumption that a bulk-buyer would continue railroad operation were contrary to the evidence (App. 417a). To accept the Commission's conclusion, however, the Three-Judge Court agreed that "the

bulk-sale discount merely reflects a market appraisal of the risks that the estate avoids, and the bulk-buyer assumes," concluding that there was an additional, measurable element of risk not already accounted for in the liquidation study that could properly reduce the net liquidation value (App. 417a-418a). But, as Judge Weinfeld pointed out, this was not the theory relied upon by the Commission (App. 439a). The Reorganization Court, furthermore, noted that the bulk-sale deduction imposed by the Commission would violate the statutory requirement of the Bankruptcy Act that sale of a debtor's property be at no less than its "fair upset price" (§77(b)(5)), pointing out that the fair upset price is the price that the market would pay, whereas the Commission's bulk-sale deduction assumes a sale at less than what the market would pay (App. 293a).

The Commission has, of course, frequently conditioned its grant of abandonment certificates to provide a preference, in the acquisition of railroad facilities proposed to be abandoned, for a person who would provide continued transportation service. Such a condition was imposed, for example, by the Commission in *Rutland Ry. Corp. Abandonment of Entire Line*, 317 I.C.C. 393, 425 (1962) so as to permit the State of Vermont an opportunity to acquire some or all of the properties for railroad purposes.[28] In every case, the condition employed by the Commission required the railroad to sell the entire line or any portion thereof "to any responsible person, firm, or corporation" offering within a specified period "to purchase the same for continued operation upon approval of this Commission, at a price *not less than the net salvage value* of the property sought to be acquired" (*Id.* at 425; emphasis added).

[28] Such a condition has been imposed in both entire line and partial abandonments. *Chicago N. S. & M. Ry. Abandonment of Entire Operation*, 317 I.C.C. 191, 200 (1962); *Arkansas and O. Ry. Corp. Abandonment*, 312 I.C.C. 501, 505 (1961); *Chicago A. & E. R. Corp. Abandonment*, 312 I.C.C. 533, 537 (1961); *Fort Dodge, Des Moines & Southern Ry. Co. Abandonment*, 312 I.C.C. 708, 712 (1961).

There is no suggestion in any of these cases that a further discount below net salvage value was imposed either directly or inferentially. Nor is there any suggestion that the Commission's use of the term "net salvage value" connotes something different from the term "net liquidation value" used in the present proceeding. In fact, in *Rutland* the Commission's report contains a listing of the components of the salvage value of the entire railroad, and no deduction for the consequences of delays in accomplishing sale was required as demanded here (*Id.* at 400).

Even if it is assumed, *arguendo,* that the Commission could fairly assume in this case that time for processing of an abandonment application during a period subsequent to January 1, 1967 would be required, it is submitted that it could not take into consideration the possibility that it might condition such abandonment upon a bulk sale. Further, even if such a condition could properly be assumed, the Commission could not fairly discount the proceeds so to be derived in determining the fair value of property which Penn Central should be required to pay. If Penn Central was fairly required to include the property in its merged system as a matter of law, it was also fairly required to pay for it at the price which, but for the public interest which demanded such an inclusion, could have been realized by the Debtor (and was so found specifically by the Commission) upon the estate's best method of liquidation.

III. THE REORGANIZATION COURT PROPERLY FOUND THAT THE LIQUIDATION VALUE OF THE NEW HAVEN'S PROPERTIES HAD BEEN UNDERSTATED BY THE COMMISSION BY AN ADDITIONAL $6,445,000.

There were two additional areas of disagreement between the district courts concerning the Commission's valuation of the New Haven properties. The Reorganization Court found that the Commission had understated

the value of two large railroad yards in The Bronx, New York by $4,439,000, while the Three-Judge Court sustained the Commission's valuation. (App. 295a-297a; App. 423a). And while the two courts agreed that the Commission's computation of the discount of liquidation proceeds to present worth was incorrect (App. 250a; App. 448a), the ultimate difference in their treatment of certain contentions made by the Bondholders produced a spread of $2,005,899 in their respective findings.

A. The Commission's valuation of the Bronx yard properties was unsupported by evidence of the nature required by the *Ecker* case, and resulted in an undervaluation of $4,439,000.

The difference between the two district courts concerning the valuation of the Bronx yard properties turns on the validity of the Commission's conclusion in its Fourth Supplemental Report that, upon liquidation of the New Haven, all railroad freight service to its Harlem River and Oak Point Yards would be terminated (App. 134a). The issue here is not whether the Commission had the right to accept one as against another of the four valuation appraisals in the record, but whether it was correct in its premise as to abandonment of rail service. The two real estate appraisals upon which the Commission relied were presented through the Trustee's witness McCann, who had submitted two appraisals to the Trustee, one for $18.1 million and the other for $22.65 million, depending upon whether rail service to the locus continued. In its Second Supplemental Report, the Commission adopted McCann's figure of $18.1 million (App. 26a). In reviewing the Second Supplemental Report, the Three-Judge Court held that the Commission had not given adequate explanation for its selection of the lower of McCann's two appraisals (App. 345a), while the Reorganization Court stated that, although "clarification of these matters" was desirable, it would not on the then record find the Commission to be in error (App. 254a.)

At the hearing following remand, McCann confirmed the distinction between his two appraisals. The higher was based upon an assumption that railroad facilities in the yards would continue, while the lower assumed that all tracks, electric power and other railroad facilities would be removed from the two yards (App. 129a-130a).

Thereupon, for the first time, evidence was directed to the question whether it was reasonable to assume that upon liquidation of the New Haven there would no longer be railroad service available to these large yard properties. That evidence showed, among other things, that the Oak Point Yard serves the newly established Hunts Point Wholesale Market, which the Commission found to be "the largest receiver" of rail traffic in the area (App. 130a). It also made clear the importance of the Hunts Point Market to Metropolitan New York, the fact that the Market is already being expanded, and its substantial use of railroad freight service (App. 131a).

The Commission recognized that McCann's lower valuation required an assumption of the discontinuance of all rail service to the Hunts Point Wholesale Market, and concluded that, upon liquidation of the New Haven, all rail service to Hunts Point would actually be terminated (App. 134a). In reaching this conclusion, the Commission went outside the record to rely on its own studies purporting to show that the type of traffic destined to Hunts Point is unprofitable (App. 132a-133a). In addition, it found "the record does not support any finding of substantial need for Penn Central service that would justify the construction by that carrier of the trackage necessary to connect Harlem River and Oak Point yards and the latter yard and Hunts Point, if NH were to be liquidated" (App. 134a). It went on to conclude that "on this record, and the assumption of NH's liquidation and the dismantling of its system, Penn Central would not serve, and could not be compelled to serve, the Harlem River or Oak Point industries, or the Hunts Point Market" (App. 134a).

In its second review, the Three-Judge Court declined to disturb the Commission's conclusion, stating that "evaluation of the probable scope of future rail service to these properties in the event of liquidation of NH lies in an area peculiarly within its expertise" (App. 423a). Judge Weinfeld disagreed. He referred to the "Commission's equivocal statement" in the Fourth Supplemental Report that "it is extremely doubtful that railroad service would continue" to the two yards if New Haven were liquidated; and found that statement to be "far from persuasive" (App. 442a). Noting that the record contained nothing to support the Commission's assumption that the railroad properties "would be stripped of their trackage and electricity, both highly desirable industrial features", he found the Commission's finding of a value of $18.1 million for these properties to be without substantial evidentiary support (App. 443a).

The Reorganization Court also found the Commission's use of the lower McCann appraisal to be unsupported by the evidence. It referred to the additional testimony placed in the record following review of the Second Supplemental Report, and found that "instead of assuming that the industrial development of the 160 acres of the two yards would not make a spur track connection economically feasible, the Commission should have concluded precisely the opposite" (App. 296a). The Reorganization Court noted that the tracks through the Bronx yards are the connecting links between Penn Central's Port Morris branch and the Hunts Point Wholesale Market, the fact that the Market had cost some $100 million, and that the yard tracks lie between the Market and New York Connecting Rail Road.[29] Noting the importance of the Market in the supply of food to Metropolitan New York, the Reorganiza-

[29] This carrier was jointly owned by Penn Central and the New Haven on a 50-50 basis prior to New Haven's inclusion in Penn Central, and provided a route between the New Haven and Penn Central and other railroads (App. 131a).

tion Court characterized as "absurd" the Commission's assumption that the State and City of New York would permit this "life line" to be cut under any circumstance (App. 297a).

The Commission's determination in this instance that, in effect, it was certain it would permit abandonment of what was about one-fourth of the appraised value of the New Haven's real estate (App. 135a) may fairly be contrasted with its general views as to permitting the New Haven to abandon property. In dealing with the general rather than the specific, the Commission stressed that "a mere showing of operating losses was not sufficent," and that (App. 145a):

> "We must hear the communities that would be affected by the abandonment. If there is hope of a public takeover of segments, we must allow time for the States and communities to present their plans."

The Trustee submits that the Reorganization Court's conclusion was plainly correct. It is not credible for the Commission to conclude without any evidence that the public interest would permit discontinuance of rail service to the Hunts Point Wholesale Market. The Commission is not entitled, on the record before it, to find that in the event of the New Haven's liquidation, and even if Penn Central could not be required to make expenditures to make its nearby service available, the State and City would not take the necessary action to preserve the service by lease, subsidy, operating arrangement or otherwise. The effect of any such arrangement would be to meet the condition for McCann's higher valuation.

B. The Commission erred as a matter of law in its determination of the discount to present worth; the Reorganization Court properly determined that the discount should be decreased by $2,415,899.

In computing net liquidation value in the Second Supplemental Report, the Commission discounted the proceeds

of liquidation to present worth. Both the Three-Judge Court and the Reorganization Court held that the Commission had erred in failing similarly to discount the expenses of liquidation (App. 331a-332a; App. 250a).

Reviewing the Fourth Supplemental Report, the Reorganization Court noted that the Commission had adjusted certain valuations from those found in the Second Supplemental Report but had failed to make the compensating adjustment to the discount to present worth. It directed the Commission, accordingly, to supply the corrections necessary to produce a correct computation of the discount (App. 302a).

The Commission furnished a computation limited solely to the valuation changes made in the Fourth Supplemental Report (S. App. 499c). In the Reorganization Court, the Bondholders agreed with that computation so far as it went, but argued that substantial further corrections were necessary, in large part because the Commission's computation of the discount of liquidation expenses was inconsistent with the manner in which it computed the discount of liquidation proceeds (S. App. 502c).

In finding as a matter of law that $2,415,899 should be added to liquidation value, the Reorganization Court accepted both the corrections furnished by the Commission and those computed by the Bondholders. The Three-Judge Court, however, adopted only the Commission's corrections which amounted to $410,000, noting, however, that the Bondholders' computations were not properly before it and that this was another matter for ultimate resolution by the Supreme Court (App. 445a).

This conclusion of the Three-Judge Court was consistent, in principle, with its view that its scope of review is very limited (App. 406a). Nevertheless, in referring to its prior opinion on the Second Supplemental Report, and noting that the principal errors which it found at that time included "two arithmetical errors aggregating more than $20 million", the Three-Judge Court did not hesitate to

state that such errors "could have been corrected without a remand" (App. 405a).

It is submitted that both district courts were plainly correct in distinguishing a challenge to the method of computing the discount to present worth from an attack on "the Commission's economic judgments" (App. 406a). In terms of the *Ecker* case, the Reorganization Court was entitled to find that the Commission's computation of the discount to present worth was obviously in error as a matter of arithmetic and, accordingly, did not meet legal standards. Having reached that conclusion, it was wholly within its province, as the Three-Judge Court would also agree, to correct a mistake in computation without a remand.

CONCLUSION

The Reorganization Court's findings as to the Commission's legal errors should be sustained and the case returned to the Commission with instructions to modify its findings in accordance therewith for purposes of its orders in the premises under Section 5 of the Interstate Commerce Act and Section 77 of the Bankruptcy Act.

Respectfully submitted,

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February 25, 1970